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Congress is endeavoring to enact comprehensive legislation that will bring many changes to bankruptcy law. It is presently studying two proposed bankruptcy bills: the Commission Bill, proposed by a Congressionally established study commission; and the Judges' Bill, submitted by the National Conference of Bankruptcy Judges. The author compares the major significant proposals of these two bills and analyzes their impact on reform of bankruptcy law.

I. Introduction and Background

Writing a new comprehensive bankruptcy act for a country with a highly developed commercial and financial structure such as ours is a colossal task. The subject matter to be considered is extensive, detailed, and complex. One would imagine that any legislative body would approach the task with considerable misgiving and reluctance. Yet from all present indications, it now appears quite probable that Congress in the relatively near future will enact comprehensive legislation that will bring many changes to our bankruptcy system.

A number of fairly recent events makes such a forecast possible. In 1970 Congress established a study commission[1] consisting of nine members to conduct an in-depth, conceptual, and factual study of the entire subject of bankruptcy. In July 1973, following extensive hearings and independent studies, the Commission rendered its report.[2] The report consisted of three parts: Part I contained the find-

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1. 84 Stat. 468 (1970).

2. Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973).

ings and recommendations of the Commission; Part II contained the full text of a new proposed bankruptcy statute to implement and effectuate the Commission's work; and Part III comprised a collection of articles related to bankruptcy. Shortly thereafter the text of Part II of the report was introduced in Congress as a proposed bill. This bill has since become generally known as the Commission Bill.[3]

Being of the opinion that some of the Commission's major proposals were improvident and unacceptable and could be improved upon, the bankruptcy judges acting through the National Conference of Bankruptcy Judges, an organization of 50 years standing, set about preparing their own proposals for comprehensive changes in the bankruptcy system. In undertaking and planning this task, they adopted the numerical sequence of sections as well as the subject matter development that coincided substantially with that found in the Commission Bill. The Judges' Bill was introduced in the Congress approximately 1 year later.[4]

In the 94th Congress these two bills[5] are the ones which both House and Senate Judiciary Sub-Committees, along with their capable staffs of attorneys, are now seriously studying and comparing with a view toward putting together a work product that can be brought to an early vote in the committees. In January 1976 the Senate Judiciary Sub-Committee completed its hearings, and in March 1976 the comparable body inthe House completed its public hearings. Both Committees are planning early mark-up sessions with a view to producing a final product.

It is the limited intent and purpose of this article to compare these two bills with reference to their major significant proposals. An article of this limited dimension, dealing with so vast a subject, of necessity requires a selection of material for treatment. Each bill runs to nearly 300 pages of detailed subject matter. These bills and the current Bankruptcy Act[6] provide persuasive evidence that the subject of insolvency and bankruptcy comprises one of the most pervasive and complex bodies of law in our system of jurisprudence.

In order to sharpen the perspective of this article a few comments about the present system of bankruptcy administration should prove helpful. At the outset, one must not assume that the present system of dealing with insolvency is wholly deficient and outmoded. Such an assumption would be misleading. The present system has evolved over a period of more than 75 years since the

3. H.R. 31, 94th Cong., 1st Sess. (1975) [hereinafter cited as H.R. 31].
4. Now H.R. 32, 94th Cong., 1st Sess. (1975) [hereinafter cited as H.R. 32].
5. H.R. 31 and H.R. 32.
6. 11 U.S.C. §§ 1 *et seq.* (1970).

Bankruptcy Act of 1898[7] through many amendments for remedying or improving specific areas, by a great store of judicial interpretation, and by experience with administration of bankruptcy under that Act. Over a quarter of a million cases are now being administered annually under that system.[8] The subject of bankruptcy has been under constant study and discussion for improvement by academic scholars, judges, and leading practitioners working through such prestigious organizations as the American Bar Association, the National Bankruptcy Conference, The National Conference of Bankruptcy Judges, and others. The subject is literally alive with discussion and comment in law journals, law reviews, and other legal periodicals.

Despite the increasing importance the subject is having for the public generally, and for the legal profession in particular, bankruptcy administration in this country has always had an inherent identity problem. This has been due in large part to the fact that from the beginning Congress elected to place exclusive jurisdiction over bankruptcy matters in the United States District Courts. Bankruptcy was considered merely a segment of a much broader spectrum of jurisdiction which Congress had given over the years to these federal trial courts. For the most part, over the last 25 years, the judges of the district courts have given only passing attention to cases associated with their bankruptcy jurisdiction. The tasks associated with bankruptcy administration were for the most part delegated to their Referees in Bankruptcy who in earlier years exercised powers comparable with that of a Special Master. However, in the Chandler Act Amendments of 1938[9] the powers of Referees in Bankruptcy[10] were greatly enlarged and their responsibilities in-

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7. 30 Stat. 544-66 (1898), *as amended*, 11 U.S.C. §§ 1 *et seq.* (1970).

8. ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 152-53 (1975).

9. 52 Stat. 840-940 (1938).

10. Referees have been functioning as judges since the Chandler Act Amendments of 1938. Chapter I, section 1 of the Bankruptcy Act on Definitions specifies that the definition for the term "court" whenever it is used throughout the Act means the judge (United States District Judge) or the referee of the court of bankruptcy. Their jurisdiction and powers in bankruptcy matters are co-equal with the exceptions noted in section 41(b) as to punishment for contempts and in Chapter X Reorganizations.

Congress has neglected to change the designation of referees to that of judges. However, in the early 1970's the United States Supreme Court promulgated new Bankruptcy Rules of practice and procedure for Chapters I to VII of the Act which provide for the designation of referees sitting as Bankruptcy Judges. Referees sitting as Bankruptcy Judges preside over the Bankruptcy Courts and hear and determine (without jury) all matters and controversies that may arise in a bankruptcy proceeding. Presently under 11 U.S.C. § 62(a) (1970) Bankruptcy Judges are appointed for terms of 6 years by the judges of the United States District Court in which they are to serve. Where the incumbent is performing satisfactorily, reappointment is generally the rule.

creased. Following World War II when the credit system, especially consumer credit, expanded rapidly with the enormous economic growth of this country, the work and the number of Referees increased markedly. Nevertheless, whatever increase the bankruptcy courts gained in regard and respect they always remained locked in the subordinate position of being an integral part of the United States District Courts—a court within a court.

But living creatures upon reaching maturity tend to want to be on their own! Accordingly, both bills presently before the Congress provide for taking bankruptcy out of the United States District Courts and creating new and separate courts for the system. Each bill would do this with different results. Thus both bills remedy the long standing identity problem for the bankruptcy courts of this country whether that result was intended or not. It is known, however, that in both bills these courts will be given greater dignity and status in our judicial system. That is as it should be, for the subject of bankruptcy has come of age.

II. STRUCTURAL CHANGES

The Commission Bill[11] would create a new and separate bankruptcy court[12] in which bankruptcy judges would deal exclusively with hearing and determining litigated matters. They would be relieved of all administrative duties with refernce to bankruptcy cases. The judges of these courts would be appointed for 15-year terms by the President with the advice and consent of the Senate.[13] The Commission anticipates that a lesser number than the present 220 bankruptcy judges would be required to operate the system. Broad powers would be conferred upon these courts to hear and determine all matters relating to bankruptcy.[14] Their jurisdiction would be exclusive. Jury and non-jury trials would be authorized,[15] abolishing the present troublesome distinction between summary and plenary jurisdiction. Under the Commission Bill, appeals from these courts would be taken to the United States District Courts. Further appeals would go in the usual manner to the Courts of Appeal and to the Supreme Court.[16]

The Judges' Bill would also give the judges of the new bank-

11. H.R. 31.
12. *Id.* § 2-101.
13. *Id.* § 2-102.
14. *Id.* § 2-201.
15. *Id.* § 2-207.
16. *Id.* § 2-210.

ruptcy courts a 15-year term,[17] but, in an obvious endeavor to keep these appointments out of the political arena, it is proposed that the selection and appointments of judges for these courts be made by the Judicial Councils of the Circuits. This was an obvious compromise of a sort. One would surmise that this proposal for appointment authority will not appeal to the Congress. During the hearings on the bills the bankruptcy judges agreed to go along with the notion of presidential appointments.

The Judges' Bill would also confer upon these courts the broadest subject matter jurisdiction.[18] However, the judges propose that appeals from the bankruptcy court go directly to the Courts of Appeal and the Supreme Court, by-passing the District Court completely.[19] The National Bankruptcy Conference joins in this proposal of direct appeal to the Courts of Appeal and the Commission does not oppose.

In its studies and hearings the Commission found "substantial reasons"[20] for not involving the new bankruptcy judges with the administrative detail commonly associated with all bankruptcy cases. Under the present system when a bankruptcy case is instituted the bankruptcy judge does at least the following things. He examines the petition, the accompanying schedules, and statement of affairs to determine that they are complete and in proper order. Similar scrutiny is given to other papers filed in the case. He presides over and conducts the first meeting of creditors as well as all subsequent meetings. He examines the bankrupt and other witnesses, approves the election of trustees and committees of creditors, and appoints trustees when the creditors fail to elect. He authorizes the employment of counsel where necessary, as well as appraisers, accountants, and auctioneers to assist the trustee during administration of the estate. He audits the accounts of trustees and orders distribution.[21] This and much more is done in addition to the judicial duties the judge performs in hearing and determining all contested and adversary matters which may arise during the case.

Under the Commission Bill all of the foregoing functions associated with administration are to be severed from those which are

17. H.R. 32, § 2-102.

18. *Id.* § 2-201.

19. *Id.* § 2-209.

20. The Commission believed that when Bankruptcy Judges participate in the prior administrative aspects of bankruptcy proceedings, it tends to impair the litigants' confidence in the impartiality of the court's decision. REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93d Cong., 1st Sess. 5-6 (1973).

21. Bankruptcy Act, 11 U.S.C. §§ 44(a), 67, 72 (1970); Bankruptcy Rules 209(b), 215-16, 11 U.S.C. app. (Supp. V 1975).

purely judicial in all liquidation and wage earner cases. To accomplish this change the Commission proposes that a new agency be created by the Congress in the executive branch of the government to be known as the United States Bankruptcy Administration.[22] This agency would have its central office in the nation's capital, regional offices at strategic locations throughout the country, and hundreds of local offices to facilitate easy access by the public.[23]

The Administrator of this agency would be appointed, without regard to political affiliation, by the President for a term of 7 years. There would be a limited number of appointments by the Administrator for high level offices in the administration, all serving at his pleasure. The remaining officers and staff throughout the country would be graded appointments under Civil Service.[24]

This proposal is one of the Commission's most controversial recommendations. If adopted by Congress this would mark the first time in United States' history that the executive branch of government has had a direct part in bankruptcy administration. Bankruptcy, in all its aspects, has always been a part of the judicial branch of government. There are many who believe that Congress is not inclined to create new major agencies in the executive branch at a time when public opinion appears to strongly favor reducing the number of government agencies. Moreover, even if that were not so, it does not appear that enough evidence has been produced by the Commission to induce the Congress to remove bankruptcy from its traditional setting in the judicial branch. The National Bankruptcy Conference, to which some of the Commission belong, recommends that the agency remain within the judicial branch.

In developing its idea for this agency the Commission proposes that all bankruptcy cases when instituted be filed with the agency rather than with the clerks of the courts as under present practice.[25] Where the petitioner is an individual with regular income the Administrator, acting through his subordinates, would counsel the petitioner as to the relief available to him under various chapters of the act.[26] The legal profession has been highly critical of this proposal authorizing an executive agency of government to counsel and give legal advice.

Following a filing the Administrator would have complete juris-

22. H.R. 31, § 3-101.
23. *Id.* § 3-103.
24. *Id.* § 3-102.
25. *Id.* § 4-202(b).
26. *Id.* § 4-203.

diction over all elements of bankruptcy administration.[27] His agency would prepare and dispatch all notices to creditors required during the proceedings.[28] Creditors would file their claims where required with the Administrator.[29] The Administrator would automatically become the trustee in all cases[30] and would take custody and control of the debtor's assets, set aside claimed exemptions and inventory, and appraise and sell the assets, all under staff supervision and control. He would collect all moneys of the estate, including filing fees, and deposit them in the Treasury of the United States in a fund to be known as the "Bankruptcy Administration Fund."[31] The agency itself would operate with funds appropriated by the Congress. The Administrator would fix all fee schedules and charges assessed against each estate.[32] His office would also make the distribution to creditors.

There would be no meetings of creditors, except in those instances where a majority of creditors holding at least 35 percent in amount of the unsecured debt make written request to vote for a private trustee.[33] In all other cases the trustee would be the Administrator as public trustee. Except in cases where a private trustee is requested in the manner set forth above, creditors in their notice from the Administrator would merely be informed of the institution of the bankruptcy case by a named debtor, the nature of the proceeding, the place where the debtor's schedules are filed and may be seen, the time permitted for requesting the election of a private trustee, the time and place for filing proofs of claim, if such are to be filed, and the legal effect which the proceedings have for the stay of civil actions and the enforcement of liens and judgments against the debtor. The notice may also contain the time fixed for filing objections to discharge or complaints to determine the dischargeability of specific debt.[34]

This agency for centralized administration would be authorized and expected to employ the latest techniques in computer processing of all data in the cases being administered, including printouts of standardized notices to creditors and routine standardized administrative orders.

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27. *Id.* § 4-301.
28. *Id.* §§ 4-307 to -308.
29. *Id.* § 4-401.
30. *Id.* § 4-304.
31. *Id.* § 3-301.
32. *Id.* § 3-302.
33. *Id.* § 5-101.
34. *Id.* § 4-307.

In short, the entire congeries of duties associated with bankruptcy administration would be centered in the proposed agency. Only when any contested or adversary matter arises is the matter then referred by the agency to the bankruptcy court for determination. Under the Commission Bill the new bankruptcy courts would have a function that is purely judicial, nothing else.

Both bills would accord to the new bankruptcy courts the broadest jurisdiction to entertain, hear, and determine all matters relating to bankruptcy. However, in the Commission Bill jurisdiction over Railroad Reorganizations is left with the United States District Courts where such jurisdiction now resides.[35] On the other hand, the Judges' Bill provides that Railroad Reorganizations shall be a part of the exclusive jurisdiction of the new bankruptcy courts.[36]

There can be little doubt that the Commission in making its proposal for separating administrative and judicial functions was influenced considerably by the striking statistic that each year approximately 90 percent of all bankruptcy cases filed throughout the country are consumer oriented.[37] Commonly these cases have few or no assets to distribute to creditors after setting aside debtors' exemptions; business assets are not involved. The Commission was obviously looking for an administrative system that would deal effectively with this large body of cases. A considerable portion of these cases, however, are centered in about a dozen states.

The Judges' Bill leaves the new bankruptcy courts with many of their present characteristics insofar as their function is concerned.[38] The bill proposes that these courts be located in convenient places throughout the country with regions that are not necessarily coterminus with those of the District Courts. Their locations would be determined following a survey. They would be staffed as they now are with clerks, with whom petitions would be filed initially, who would keep and maintain the records, and prepare and dispatch all notices to creditors. These courts would retain their present responsibilities of supervision and control over administration of the cases before them and exercise the broadest jurisdiction to hear and determine all matters relating to bankruptcy. The court would be staffed with court reporters, bailiffs, and law clerks. Jury and non-jury trials would be conducted. The distinction between

35. *Id.* § 2-201.

36. H.R. 32, § 2-201.

37. ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES 152-53 (1975).

38. H.R. 32, §§ 2-101 to -209.

summary and plenary jurisdiction would be abolished.

Under the Judges' Bill a certain amount of supervision and administrative correlation would be centered in a "Bankruptcy Branch" in the Administrative Office of the United States Courts.[39] The clerks of the courts and the trustees in each case would remit all moneys coming into their hands to the Director of the Administrative Office of the United States Courts, who would be charged with their management and investment in interest bearing deposits or in short-term government securities.[40] Many millions of dollars would be involved in this fund at all times. Distributions in each case would be made from this fund.

The Judges' Bill rejects the idea of a public trustee in all liquidation and wage earner type cases as proposed by the Commission. The Judges propose that a panel of qualified persons be named by the Director of the Administrative Office of the United States Courts to serve as trustees.[41] Each individual named would have to have an office or residence in or adjacent to the territory to be served by a bankruptcy court. If authorized by its charter, a corporation could also qualify for the panel. The Director would make the appointment of the trustee in all liquidation cases. In other cases the court could also direct the Director to appoint a trustee.

It can readily be seen that both bills have rejected and abandoned the principle of "creditor control." Those familiar with the way creditor control works in actual bankruptcy practice must concede that the democratic system of creditor participation has been an unachieved ideal. Lack of broad based creditor attendance and participation in meetings of creditors throughout the proceedings has been the prime cause of the failure of that system. Whether the public trustee idea or the rotating panel of qualified trustees selected by an agency rather than by the creditors or by the courts is going to produce a better system only time will tell.

It should not be assumed, however, that the Congress will limit its selection to one or the other of the new or modified concepts set forth in these two bills. There will be some tradeoffs in the legislative process, and the Congress may be expected to come up with some ideas of its own. The public hearings conducted by the two sub-committees have produced critical comments and alternate proposals. The National Bankruptcy Conference has proposed numerous modifications for both bills. Experience has confirmed what

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39. *Id.* § 3-101.
40. *Id.* §§ 3-102 to -103.
41. *Id.* § 4-301.

was said at the outset—writing a new comprehensive bankruptcy act is a collossal task.

III. SUBSTANTIVE CHANGES

While the structural changes proposed for the new bankruptcy system are most important the proposals for substantive change deserve considerable attention as well. Again it is necessary to be selective.

State law is preempted in such areas as the debtor's exemption, inchoate dower and courtesy interests, spendthrift trusts, and for ipso facto termination clauses in leases. The law of preferences has been modified to simplify its proof, as has the order of priorities among claims. The Uniform Commercial Code has been brought into better correlation with bankruptcy with respect to preferences. The legal effect of a discharge is strengthened to avoid and prevent reaffirmation of a discharged debt. The provability of a claim would no longer be essential to its allowance. The concept of unconscionability has been borrowed from the Uniform Commercial Code as one of the grounds for disallowance of a claim. The government's priority for tax claims would be greatly limited, and property of the estate would no longer be measured by leviability and transferability under state law as it is at present. This brief recital constitutes but a small part of the long list of substantive changes that are to be found in both bills, many of which will surely find their way into the new act. An attempt will be made to look more closely at a few of these subjects.

In the area where state law would be preempted both bills propose a national debtors exemption law for bankrupt debtors.[42] The proposals are broad and lengthy. In general the Commission would grant an individual debtor a homestead exemption up to $5000 plus $500 for each dependent. The Judges' Bill would allow $6000 plus $600 for each dependent. Where the homestead does not exhaust the allowable limit, the balance could be allocated to other property of the debtor, but with an outside limit of $25,000 for all categories. If the exemption allowed by state law was greater, the debtor could elect to claim it instead. Both bills contain a long list of property which may be claimed as part of the exemption in addition to the homestead, including such items as alimony, support and maintenance, benefits or proceeds from life insurance, pensions, annuities, income tax refunds, livestock, and cash or receivables to a limit of $500.

42. H.R. 31, § 4-503; H.R. 32, § 4-503.

The proposed federal preemption of state exemption laws in bankruptcy constitutes a new area for federal intrusion. Most recently the government has done the same thing on the subject of garnishment of wages.[43] The effect here would be to bring uniformity to an area of law that has had great disparity. Under current bankruptcy law state exemption laws are applicable. How well the proposed system would work is difficult to foretell. What is certain, however, is that under the proposed liberalized system there would be few cases with dividends for creditors after setting aside exemptions. Valid security would generally consume what is left.

Both bills contain a provision making unenforceable a waiver of exemptions in favor of a creditor who does not hold valid security in property. Likewise, a lien obtained by legal or equitable proceedings and one created by agreement to give security on wearing apparel, household goods, and health aids, other than a purchase money obligation, would also be unenforceable against property allowed as exempt.

Under the present Bankruptcy Act one of the grants of power to the bankruptcy courts is to

> determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property in any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest.[44]

Both bills contain provisions that would terminate all such marital interests in property of the estate as of the date the petition is filed,[45] where such property has not been set aside as part of the exemption or abandoned as burdensome.

Another example where the federal government in exercise of its bankruptcy powers would preempt an area left previously to the states is that of spendthrift trusts.[46] Generally, these are donor instruments, inter vivos or testamentary, which establish trusts in property with provisions insulating principal and income from the donee-beneficiary's creditors, and restrict or forbid alienation or anticipation by the donee-beneficiary of his interest by assignment, pledge, or other devise.[47] Where the amount of property and income that is protected by these trusts is large, a beneficiary's bankruptcy could prove most awkward. Accordingly, both bills take care of this

43. Consumer Credit Protection Act, 15 U.S.C. § 1671 (1970).
44. 11 U.S.C. § 11(7) (1970).
45. H.R. 31, § 4-601(c); H.R. 32, § 4-601(c).
46. H.R. 31, § 4-601(b); H.R. 32, § 4-601(b).
47. G. BOGERT, HANDBOOK OF THE LAW OF TRUSTS § 40 (5th ed. 1973).

possible loophole. The insulating provisions of such a trust are enforceable against the beneficiary's bankruptcy trustee only to the extent of the income therefrom which is found by the bankruptcy court to be reasonably necessary for the support of the debtor and his dependents. The actual mechanics of dealing with such a trust have yet to be worked out.

An additional provision having to do with property of the estate which would have the effect of preempting state law is the enforceability of a provision in a contract or lease which ipso facto terminates or permits a party other than the debtor to terminate the contract or lease because of the insolvency of the debtor, or the commencement by or against him of a bankruptcy case.[48] Both bills would permit such provisions in a contract or lease to be enforceable in liquidation proceedings, but not in wage earner plan,[49] arrangement,[50] and reorganization[51] cases. In the latter three situations, however, unenforceability is conditioned upon all defects in performance being cured and adequate assurance for future performance provided.

The voidability and recovery of preferential transfers of money or property have always provided troublesome problems of proof for the bankruptcy trustee. Under present law his burden is substantial. In order to avoid a claimed preference the trustee must show: (1) a transfer of property by conveyance, assignment, sale, payment, pledge, lien or encumbrance, or other device; (2) to or for the benefit of a creditor; (3) for or on account of an antecedent debt;

48. H.R. 31, § 4-602(b); H.R. 32, § 4-602(b).

49. A wage earner plan is one proposed by a petitioner under chapter XIII of the Act. An individual who qualifies as a wage earner as defined in the chapter proposes a plan calling for a composition or extension of his unsecured debts to be paid out of future earnings. If the proposed plan merely extends the time for paying the indebtedness, as it frequently does, the petitioner undertakes to pay 100 percent of his unsecured indebtedness. In those cases where the petitioner obtains written consents to his proposal from a majority both in number and amount of his unsecured creditors, the plan comes before the court for confirmation following a hearing held upon notice to all creditors. After confirmation the plan is binding upon the debtor and on both consenting and nonconsenting unsecured creditors. Where the plan proposes a composition of debt or a composition and extension, the wage earner undertakes to pay a stated percentage of his unsecured debt over a period of time out of future earnings. The confirmation procedure for such a plan is the same as for simple extension.

50. Arrangements are another form of debtor relief and rehabilitation. These proceedings are instituted by individuals and corporations under chapter XI of the Act. Composition and extension of unsecured debt is the subject matter of the proceeding. Confirmation of a plan accepted in writing by a majority in number and amount of the creditors affected by the plan is binding upon all classes of creditors affected whether or not they accepted the plan.

51. Corporate reorganizations are effected under chapter X of the Act. The chapter is employed for debtor relief and rehabilitation only in the larger corporate cases. The plan usually affects not only trade indebtedness, whether secured or unsecured, but also indebtedness related to the corporation's capital structure, which affects security holders.

(4) made or suffered by such debtor while insolvent; (5) within four months before the filing of a petition initiating a proceeding by or against him under the Act; (6) the effect of which transfer would enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class; and (7) the creditor or his agent acting with reference thereto had at the time when the transfer was made reasonable cause to believe that the debtor was insolvent.[52]

The Commission Bill cuts the period of time to 3 months,[53] whereas the Judges' Bill retains the 4 month period.[54] In both bills the preference voidability is one year where the creditor obtaining the transfer is a so-called "insider" by being a member of the debtor's immediate family, a partner, an affiliate, a director, officer, or managing agent of or for the debtor.[55] A number of transactions are excepted from preference voidability in both bills. Among these are enabling loans and security interests on inventory and accounts receivable.[56] Statutory liens and common law liens are also excepted.[57]

The priorities for many classes of claims have been drastically altered in both bills.[58] Under current law debts that are accorded priority in advance of the payment of dividends to creditors are the following: (1) the costs and expenses of administration; (2) wages and commissions earned within 3 months prior to bankruptcy up to a limit of $600 for each claimant; (3) reimbursement of the costs and expenses of one or more creditors whose efforts defeated confirmation of an arrangement or wage earner plan, or whose objections to discharge resulted in the discharge being refused, revoked, or set aside; (4) taxes; (5) debts other than for taxes owing to the United States or to any person who by the laws of the United States is entitled to priority; and (6) rent owing to a landlord entitled to priority by applicable state law, but limited to rent that is legally due and owing for actual use and occupancy of the premises and which accured within 3 months of bankruptcy.[59]

Under both bills these priorities would be the following: (1) administrative costs and expenses; (2) amounts due on transactions with a involuntary bankrupt prior to adjudication; (3) compensation for personal services, including vacation, severance, and sick-

52. 11 U.S.C. § 96 (a)(1),(2) (1970).
53. H.R. 31, § 4-607(a)(1).
54. H.R. 32, § 4-607(a)(1).
55. H.R. 31, § 4-607(a)(2); H.R. 32, § 4-607(a)(2).
56. H.R. 31, § 4-607(c)(1),(d); H.R. 32, § 4-607(c)(1),(d).
57. H.R. 31, § 4-607(b); H.R. 32, § 4-607(b).
58. H.R. 31, § 4-405; H.R. 32, § 4-405.
59. 11 U.S.C. § 104(a) (1970).

leave pay, earned within 3 months of bankruptcy up to a limit of $1200 for each claimant; (4) contributions to employee benefit plans based on 1 year of service prior to the employer's bankruptcy, not to exceed $300, or the difference between $1200 and what was paid to the claimant as a priority wage, whichever is the lesser amount; (5) taxes due the United States, any state, or any subdivision thereof, generally for 1 year, and taxes withheld from wages; (6) all other claims not subordinated by any of the provisions of the act; (7) tardily filed claims that are not subordinated in payment; (8) interest on claims (it is not clear from the draft of these bills whether either allows interest on claims promptly filed and also on tardily filed claims); (9) claims subject to subordination.[60]

It can easily be seen that the proposed ladder of priorities is much more pervasive and complicated than those under the present statute. It is a fair assumption that Congress will alter a number of these categories for this is the area where contest and competition exists. The Treasury Department will certainly be heard from since its tax priority would be cut down from 3 years to 1 year. It is also noted that the landlord's priority is eliminated entirely. Congress will certainly hear from that group. Thus substantial revision of this section is to be expected.

As to discharges, under both bills the legal consequences of a bankruptcy discharge would be greatly strengthened by declaring the discharged debt completely extinguished.[61] Under current law a discharged debt merely gives the debtor an affirmative defense in a suit brought on the debt.[62] This, however, is accompanied by a provision of the Act (a provision also found in Bankruptcy Rule 404 (f)) prescribing that the Order of Discharge shall declare any judgment theretofore or thereafter obtained on a discharged debt in any court to be null and void.[63]

Both bills provide that notwithstanding any other law to the contrary, a debt extinguished by discharge shall not be revived or reaffirmed or be all or any part of any bargain creating a new debt. This would foreclose attempts by creditors in the future to evade the discharge barrier.[64]

It seems clear from the foregoing that the drafters of this provision were reaching out for the strongest and most affirmative language they could find to assure that the discharge under the new act

60. H.R. 31, § 4-405; H.R. 32, § 4-405.
61. H.R. 31, § 4-507; H.R. 32, § 4-507.
62. 11 U.S.C. § 35(a) (1970).
63. 11 U.S.C. § 32(f)(1) (1970).
64. H.R. 31, § 4-507; H.R. 32, § 4-507.

would be as genuine and trustworthy as man could devise. This had been a troublesome area until several years ago. Suits brought to recover a debt after bankruptcy cases were closed was a common ploy. All too often these suits were not defended. Default judgments frequently resulted, with the debtor losing some or all of the benefits he sought in bankruptcy. A similar result occurs when there is reaffirmation of debt. It is quite common under present practice for a bankrupt to reaffirm a debt that affects his essential household goods, motor vehicle, and clothing.

Under current law the commencement of a proceeding within 6 years following an earlier bankruptcy in which the debtor has obtained a discharge or in which he had a composition in an arrangement or wage earner plan confirmed is a bar to a discharge in the subsequent proceeding.[65] Under both bills this time for successive bankruptcies is reduced to 5 years.[66] However, under the Commission Bill the 5-year bar would not apply where the proceedings were under a wage earner plan. Numerous other changes are proposed in this area of successive bankruptcy.

New criteria for the allowance of claims is set forth in both bills in considerable detail. Under the present Act all claims which have been duly proved are to be allowed by the court upon their receipt or presentation.[67] This requirement for both proof and allowance of claims was modified a few years ago by Bankruptcy Rule 306(b) which provides that a claim filed in accordance with the Rules "shall be deemed allowed" for the purpose of distribution unless an objection thereto has been filed by a party in interest. Under the bills now before the Congress the requirement of provability is abolished.[68] Indeed the requirement for filing claims at all has been greatly limited under both bills.

Regarding the allowance and disallowance of claims, both bills introduce a new concept which was borrowed from the Uniform Commercial Code. It is the concept of unconscionability as a ground for disallowance.[69] In reaching a decision the courts may without limiting the scope of the concept consider the following elements as being pertinent to the issue: (1) the degree to which unfair advantage was taken of the debtor in any aspect of the transaction that gave rise to the claim, because of the debtor's lack of knowledge, ability, experience, or physical or mental capacity; (2) the substan-

65. 11 U.S.C. § 32(c)(5) (1970).
66. H.R. 31, § 4-505(a)(7); H.R. 32, § 4-505(a)(7).
67. 11 U.S.C. § 93(d) (1970).
68. H.R. 31, § 4-402(a); H.R. 32, § 4-402(a).
69. H.R. 31, § 4-403(b)(8),(c); H.R. 32, § 4-403(b)(8),(c).

tial disparity between the price of the goods or services and their value as measured by the price of the same or comparable goods or services generally prevailing in the debtor's community at the time; and (3) the definitions of unconscionability found in the statutes, regulations, rulings, and decisions of federal and state legislative, administrative, and judicial bodies. The Commission would restrict the application of the foregoing doctrine to claims filed in consumer cases; the Judges' Bill would extend the doctrine apparently to all bankruptcy cases.

The time allowed creditors to file claims differs in each bill. The present Act allows claims to be filed for a period of 6 months after the first date set for the first meeting of creditors.[70] Upon application, the court may allow an extension of the 6-month period to the United States and any state or subdivision thereof provided it is done before the initial period expires.[71] The Commission Bill sets no time for filing claims, leaving it to the Administrator to fix both the time and the place in each case in the first notice to creditors.[72] No doubt this would be determined in the regulations to be adopted and promulgated by the Administrator. On the other hand the Judges' Bill fixes the time by statute at 3 months after the first date set for the first meeting of creditors.[73] Both bills provide for extensions of time to taxing agencies on terms similar to the ones now in force.

The 3 month period for filing claims found in the Judges' Bill seems sound. The 6 month period under present law is too long and appears to be a holdover from earlier times in this country when the general pace of things was slower and transportation and communication less sophisticated. It is a reasonable expectation that the time for filing claims will be shortened considerably.

IV. BUSINESS REHABILITATION CHANGES

Until now this selective commentary has said little or nothing about the rehabilitative portions of the two bills. These are the so-called chapter cases as distinguished from ordinary liquidation bankruptcy. While it is true that the wage earner plan cases are rehabilitative in their concept and characteristics, they have been alluded to in the earlier discussion of the consumer type bankruptcy and consequently no further comment of them is made here. This

70. 11 U.S.C. § 93(n) (1970).
71. *Id.*
72. H.R. 31, § 4-401.
73. H.R. 32, § 4-401(b).

section will look briefly at what the two bills propose in the important area of the distressed business that resorts to a chapter case when it needs relief under the bankruptcy act.

Under the present Bankruptcy Act the relief provided for the rehabilitation of business debtors is found in three separate chapters: chapters X, XI, and XII. Of the three, chapter X is the most pervasive remedy. Both capital and trade indebtedness can be modified under its provisions and procedures. It is generally adaptable to the ills of the larger business corporations. Of all the chapter cases, however, the one most widely used is chapter XI providing for unsecured debt adjustment for individuals, partnerships, and corporations. Chapter XII is utilized the least; it is not available as a remedy to corporations, and it deals solely with adjustment of debt secured by real estate.

The Commission Bill would consolidate all three chapters into one.[74] The Judges' Bill would retain the distinction between business reorganizations and arrangements,[75] which would mean a consolidation only of the remedies found currently in chapters XI and XII. Thus, plans for an arrangement could provide for the extension or composition of unsecured debt as well as debt secured by real or personal property.

Both bills undertake to eliminate almost entirely the need for filing proofs of claim in the reorganization and arrangement cases. This is accomplished by requiring the trustee or debtor-in-possession to file early in the proceeding with the court or Administrator a compete inventory or schedule of the debtors property, a list of his creditors, and a list of his equity security holders.[76] The list of the names, addresses, and amounts due creditors would provide the court or the Administrator with the information required to prepare and mail the required notices. Both bills provide for discretion in requiring the filing of claims.

The Commission's proposal for consolidation of the three chapters into one and the other proposals that are a consequence of it have caused considerable alarm among experienced practitioners and the Judges. The Commission justifies its proposal for consolidation of all business rehabilitation cases by pointing out in its report that under present law the three chapters have detailed and often overlapping rules regarding availability of business rehabilitation. The Commission further maintains that much of what occurs proce-

74. H.R. 31, §§ 7-101 *et seq.*
75. H.R. 32, §§ 7-101, -201.
76. H.R. 31, § 7-103(a)(2); H.R. 32, § 7-103(a)(2).

durally in each of the chapters can be dealt with flexibly under one chapter. While there is much to be said for this latter point, one may question whether the Congress will consolidate the whole important subject of business rehabilitation. In this regard, the Judges' Bill appears more realistic. Since the Chandler Act Amendments of 1938 were added to the Act expanding the concept of bankruptcy from one of liquidation to include rehabilitation as well, the importance of bankruptcy as a legal tool to assist a business in financial distress has grown tremendously. In the hands of knowledgable and resourceful counsel these chapters have been the salvation of many distressed business enterprises. The validity and viability of such cases as an integral part of the bankruptcy scheme have been well established and justified in the bankruptcy forum over the past 35 years.

The Commission's proposal for a single consolidated rehabilitation chapter (Railroad Reorganizations are excluded) would allow the bankruptcy court discretion (where the indebtedness is less than $1 million) to retain the debtor in possession or to request the Bankruptcy Administration to supply the court with the name of a person from its regular panels to be appointed trustee.[77] In this manner the court is removed from the selection process in trustee appointments.

Where the debt exceeds $1 million and there are 300 or more public security holders, a presumption arises that a trustee is required and one is appointed. However, where the expense involved in such an appointment is deemed to be disproportionate to the protection afforded, the court may dispense with a trustee and leave the debtor in possession.[78] Receivers are eliminated entirely in rehabilitation cases. The Judges' Bill contains comparable provisions.[79]

The practice under the present Act of having creditors elect an official creditors committee to participate in negotiations with the debtor and perform other functions[80] is considerably altered in the Commission Bill.[81] The Commission instead would have an official creditors committee composed of the largest creditors appointed by the Bankruptcy Administration. If there were conflicting creditor interests the Administrator could appoint a committee for each class of creditors. Provision is also made for unofficial creditors' committees but the reimbursement of their expenses is not assured.

77. H.R. 31, § 7-102(a).
78. *Id.*
79. H.R. 32, § 7-102(a).
80. 11 U.S.C. § 72(b) (1970).
81. H.R. 31, § 7-101.

The Judges' Bill contains provisions which are very similar.[82]

The institution of an involuntary bankruptcy against a defending debtor has frequently been a time-consuming experience. This has been true whether the proceedings contemplated a liquidation or a corporate reorganization under chapter X. The burden of proof associated with establishing insolvency and the commission of an Act of Bankruptcy have often discouraged creditors from commencing the action, leaving the debtor to dissipate or otherwise deplete the assets. Not infrequently a defending debtor would also demand a jury trial of the issues. Delay and expense were the result.

The Commission Bill attempts to deal with this problem in a bold and forthright manner. It proposes to abolish the concept of "Acts of Bankruptcy" and eliminates the need for petitioning creditors to prove insolvency of the debtor. Instead, the bill proposes that after a showing that the debtor has ceased to pay his debts or is unable to pay his current obligations, a presumption of insolvency arises which the debtor has the burden of overcoming with evidence, and his right to a jury trial is no longer available. It is also provided that if the debtor had made a general assignment for the benefit of creditors or suffered the imposition of a general receivership, either in itself would be sufficient to support an involuntary petition in bankruptcy without regard to the issue of insolvency or ability to pay.[83]

Under the Act currently in force three or more creditors having unsecured claims aggregating $500 in amount may become petitioners for an involuntary bankruptcy.[84] Both bills raise this qualifying amount to $2500 for involuntary liquidation cases and fix $10,000 as the amount of claims necessary to institute an involuntary reorganization case.[85]

While the contested case is pending, the court may allow the Bankruptcy Administration to take immediate possession in order to preserve the debtor's property. During the interim period between the filing of such a petition and the determination of the issues by the court, persons dealing with the debtor are protected on transactions in the ordinary course, and the Bankruptcy Administration is authorized to give express approval to specific transactions out of the ordinary.[86]

82. H.R. 32, § 7-101.
83. H.R. 31, § 4-207(a).
84. 11 U.S.C. § 95(b) (1970).
85. H.R. 31, § 4-205; H.R. 32, § 4-205.
86. H.R. 31, § 4-208(c); H.R. 32, § 4-208(c).

In chapter X corporate reorganization cases under the present Act, where the indebtedness exceeds $3 million the court is required to notify the Securities and Exchange Commission of any plan for the adjustment of debt and to request a report.[87] The Commission Bill would change this requirement by providing that in all cases where the proposed plan would materially and adversely affect 300 or more persons holding securities, the Bankruptcy Administration would be called upon for a report regarding any plan that was to be submitted to creditors.[88] The Commission justified this proposed change by claiming that the participation of the Securities and Exchange Commission in reorganization matters was "tangential" to its main statutory mission, whereas the Bankruptcy Administration would be familiar with and intimately involved in all bankruptcy matters. The Judges' Bill on the other hand leaves the report function with the Securities and Exchange Commission.[89]

Apart from the foregoing broad based changes affecting the rehabilitation cases the Commission also modified substantive law. The limitation imposed by the Commission Bill on the enforceability of clauses in contracts and unexpired leases providing for their ipso facto termination where one of the parties resorts to or is forced into some form of bankruptcy have been discussed.[90] Another substantive modification is concerned with the right under current law of a bank holding a deposit account to set-off mutual debts immediately following the filing of a petition in bankruptcy by the debtor.[91] The exercise of this right in business rehabilitation cases has frequently had the effect of virtually aborting the case at the outset by depriving the business of the cash it needs to continue operations and preserve going concern values.

The Commission proposes that the filing of a rehabilitation case shall operate as an automatic stay of set-off by a depository bank pending a ruling by the court.[92] In those instances where the stay is continued the bank would have to be granted either a lien or a priority in any plan that the debtor proposes to protect the bank's possessory interests. The Judges' Bill is not greatly dissimilar in this respect.[93]

The common practice of public utilities threatening to cut off

87. 11 U.S.C. § 665(a) (1970).
88. H.R. 31, §§ 7-107(c), -306(b).
89. H.R. 32, § 7-305(b).
90. See note 48 *supra* and accompanying text.
91. 11 U.S.C. § 108(a) (1970).
92. H.R. 31, § 7-204(a).
93. H.R. 32, § 4-716.

essential services to a business debtor for non-payment of pre-petition bills and demanding immediate payment of such bills as a condition to continued service has been a troublesome problem for trustees and bankruptcy courts. The effect of such demands coerces the granting of a priority which is not provided for in the Act. The current solution to the problem is a court restraining order.[94] The Commission Bill provides a statutory solution; the bill contains a provision prohibiting the cutting off of essential services.[95] Payment of post-petition services is, however, safeguarded in such cases. The Judges' Bill has similar provisions.[96]

V. CONCLUSION

The foregoing constitutes some of the changes being proposed to the Congress for a new bankruptcy system. It is not easy to interest Congress in a task of this dimension. The hard underlying spadework in forging a bill with 300 pages of concentrated detail, however, was done by others for the Congress. Indeed, Congress was given two complete bills with alternate proposals from which to choose. Many knowledgeable and dedicated people are associated with this rapidly growing field of bankruptcy. The subject has come of age! It no longer has an identity problem as it did over the years.

Judiciary Sub-Committees in both the House and the Senate have set up tight schedules for mark-up sessions that hopefully will lead to early agreement and vote. Congressman Don Edwards of California, Chairman of the House Sub-Committee handling these bills stated that:

> One of the major pieces of legislation the Sub-Committee on Civil and Constitutional Rights of the House Committee on the Judiciary will be considering in the 94th Congress is the long overdue reform of the bankruptcy laws of the United States. This legislation will have a significant impact on the credit economy of the country, and deserves serious and extended study and consideration.[97]

Indeed it will! We may all rejoice at the prospect.

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94. Bankruptcy judges have the authority under the Act to "make such process, and enter such judgements, in addition to those specifically provided for, as may be necessary for enforcement of this [Act]." 11 U.S.C. § 11(a)(15) (1970). They also have the general authority of federal courts to "issue writs necessary or appropriate in aid of their respective jurisdictions. . . ." 28 U.S.C. § 1651(a) (1970).

95. H.R. 31, § 7-105.

96. H.R. 32, § 4-711.

97. STAFF OF HOUSE SUBCOMM. ON CIVIL AND CONSTITUTIONAL RIGHTS OF THE HOUSE COMM. ON THE JUDICIARY, 94TH CONG., COMPARING H.R. 31 WITH H.R. 32 (Sept. 2, 1975).